No. 5689.

IN THE

United States

Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Alameda Investment Company, a corporation, Hawley Investment Company, a corporation, Pacific Nash Motor Company, a corporation,

Appellants,

vs.

John P. McLaughlin, collector of internal revenue for the first district of California,

Appellee.

REPLY BRIEF OF APPELLANTS.

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Parker, Stone & Baird Co., Law Printers, Los Angeles.

TOPICAL INDEX.

TABLE OF CASES AND AUTHORITIES CITED.

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REPLY BRIEF OF APPELLANTS.

We believe the court will find that we have sufficiently answered in our original brief most, if not all, of the points raised in the brief of appellee. In addition certain errors in appellee's brief require correction.

The Questions.

The facts are not in dispute. The questions before this court are purely questions of law.

First, were the appellants affiliated during the calendar year 1922 within the meaning of section 240 (c) of the Revenue Act of 1921;

Second, are the appellants precluded from recovering the taxes herein sued for because of failure to pay the taxes under protest?

A third point mentioned in appellants' original brief, namely: "Assuming the appellants to be so affiliated for the calendar year 1922, are they entitled to have their tax liability computed as a unit when they originally filed separate income tax returns for said year 1922?" was not referred to in appellee's brief.

We hence assume concession with our contention that the Commissioner of Internal Revenue granted permission to appellants to file a consolidated return for 1922.

I.

Affiliation.

The facts upon which the right of affiliation is predicated need not be restated. Diagram No. 1 hereto appended illustrates graphically the facts.

In our original brief we cited the case of *Great Lakes Hotel Company v. Commissioner,* 30 Fed. (2d) 1, as an authority for the principle that the word "controlled" in section 240 (c) of the Revenue Act of 1921 was broader than the word "owned" and for authority that "control" was present where there were inter-company transactions, where the minority stockholders purchased their stock because of their good opinion of the integrity and business ability of the majority stockholders, where an oral agreement between the minority and majority stockholders existed that the minority stockholders would, in case they desired to sell their stock, first offer it to the parent company, and where the minority stockholders

gave proxies to the majority stockholders. *In that case, minority stockholders owning no stock in the parent owned from 22 to 29% of the total stock of the various subsidiary companies.* The court held that the stockholders of the parent controlled the minority stock of the subsidiaries under the above stated facts.

Appellee's brief, page 3, in referring to the Great Lakes Hotel case, says that "All parties seemed to agree that the * * * 'equitable title' to the stock of *all* corporations 'rested in the individuals of the Stevens organization', i. e., the same individuals equitably owned all the stock".

The appellee's brief then states that the Great Lakes Hotel Company case stands for the same principle as the case upon which appellee relies, *Commissioner v. Adolph Hirsch*, namely that "control" means "equitable ownership".

The findings of fact of the United States Board of Tax Appeals in that case, *Hirsch v. Commissioner*, 7 B. T. A. 707, shows that the facts as stated by appellee are erroneous. The language of the Appellate Court quoted above applied only to the stock of the parent company, and not to the minority stock of the subsidiaries. The stock of H. L. Stevens & Company was owned by its officers and employees. They, however, had executed a voting trust giving certain persons known as the "Stevens Associates" the sole and exclusive power to vote the stock of H. L. Stevens & Company owned by them. *None of the minority stock of the subsidiaries was placed in the voting trust or was owned by the "Stevens Associates".* It was in construing this voting trust agreement that the board found as follows:

> "Notwithstanding the provisions of paragraph VII of the trust agreement above quoted, counsel for both the petitioner and the respondent have apparently regarded legal title to this stock as being in the 'Stevens Associates' and the equitable title thereto as resting in the individuals of the Stevens organization indiscriminately."

The board's findings clearly show that neither the parent company, its stockholders nor the "Stevens Associates" had any interest, legal or equitable, in the minority stock of the subsidiary companies amounting to 22 to 29% of the total. The court held, however, for the reasons stated above, that the parent company and its stockholders "controlled" the minority stock in the subsidiaries and all companies were therefore affiliated.

The Great Lakes Hotel case squarely stands for the principle that statutory "control" means nothing more nor less than actual or factual control and that "control" is more comprehensive than "owned".

In the Hirsch case, the stockholders of the Hirsch Company owned but 55.63% of the stock of the Brazilian Company. *They had no control over the 44.37% minority stock* of the latter company. The decision of the court must be predicated on lack of this factual control. The court's finding relative to equitable ownership is based on the case now on appeal here, and in reality was mere *dictum.*

Diagrams Nos. 2 and 3 appended hereto show graphically the stockholdings in the Great Lakes and Hirsch cases.

II.

Payment Under Protest.

A. This Tax Was Paid Under Protest.

We believe the question of protest to be foreclosed by the record. The complaint shows that the tax in this case was paid under protest. [Complaint, Rec. p. 6.]

The answer did not deny this material allegation. [Rec. pp. 13 to 18.] The findings of fact, conclusions of law [Rec. pp. 23 to 25] and judgment on the findings [Rec. pp. 26 to 27] do not state that the taxes were voluntarily paid. While the opinion of the lower court [Rec. pp. 20 to 23] implies voluntary payment, there is nothing in the record to justify such a conclusion.

The pleadings and findings of fact by the lower court must be the guide of this court as to the facts.

> Kendrick Coal & Dock Co. v. Commissioner (C. C. A., 8th Circuit, November 7, 1928) and the cases therein cited.

Material allegations not denied by the answer are taken to be true. This is the statutory rule in California.

> California Code of Civil Procedure, section 462; Appellant's original brief, p. 28.

It is also a well-known rule that "the practice, pleadings and forms and modes of proceeding in civil causes * * * in the District Courts must conform as near as may be to the practice, pleadings and forms and modes of proceeding existing at the time in like causes in the courts of record of the state within which such District Courts are held, any rule of court to the contrary notwithstanding".

> Revised Statutes, sec. 914.

It is equally well settled that admissions in pleadings have judicial force and are binding upon the pleader and cannot be controverted by the pleader in any stage of the case, either in the trial court or on appeal.

Bancroft's Code Pleading, vol. I, section 429;
Rogers v. Brown, 15 Okla. 524, 86 Pac. 443.

This is true whether the admission is in the complaint or is an admission by failure to deny allegations of the complaint.

Bancroft's Code Pleading, sec. 431;
Ensele v. Jolley, 188 Cal. 297, 204 Pac. 1085.

It is therefore clear from the above citations and reference to the pleadings that the taxes herein sought to be recovered must be deemed to have been paid under protest.

B. Payment Under Protest Is Not Essential.

For the benefit of the court, some reference should be made to appellee's contentions with regard to payment under protest, although we consider this discussion academic only.

The appellee's brief makes a plea to spare the collector from the hardship of a personal judgment against him.

The Revenue Acts specifically provide that the government must pay all judgments recovered against a collector upon the issuance by the court of a certificate of probable cause. The government even furnishes defense counsel for the collector.

In *Weir v. McGrath,* U. S. District Court, Southern District of Ohio, Western Division, decided May 21st,

1928, paragraph 1659, 1928 Prentice-Hall, 6 American Federal Tax Reports (unreported), the court said in construing section 1014 of the Revenue Act of 1924:

> "It is our opinion that the addition of a provision making protest or duress unnecessary is but a recognition of the fact that in substance and true effect the recovery is from the government and an example of liberality and fairness upon the part of the government and a disinclination to retain the benefit of that which has wrongfully been collected whether technicalities have been complied with or not."

The appellee's brief on page 4 states that the elimination of payment under protest as set forth in section 1014 of the Revenue Act of 1924 does not apply to taxes already paid.

Section 1014 must refer to taxes already paid. The only limitation is that it does not cover suits already instituted. The report of the committee on ways and means dated February 11, 1924, quoted page 36, appellants' original brief, indicates clearly that Congress was dealing with taxes that had already been paid.

Appellee's brief questions the power of Congress to deprive the collector of an existing defense. It is well settled that the legislature may deprive a party of technical defenses involving no substantial equities.

12 Corpus Juris 973;
West Side Belt Railroad Co. v. Pittsburgh Construction Co., 219 U. S. 92.

No federal statute ever required that taxes be paid under protest as a condition precedent to their recovery. If such a condition precedent exists, it must be predicated

on case or common law. There is no vested right in a mere rule of the common law.

Chicago Railroad Co. v. Tranbarger, 238 U. S. 67;
Mondo v. N. Y. Railroad Co., 223 U. S. 1.

It is also well settled that Congress has the power to take away from a collector a common law defense as to taxes which have already been paid provided the defense was a technical one only.

> "Statutes removing conditions precedent to the maintenance of an action may operate retrospectively without interfering with vested rights as they affect the remedy only."
>
> 12 Corpus Juris p. 976.

See, also:

Brainard v. Hubbard, 12 Wall (U. S.) 1;
Phoenix Insurance Co. v. Pollard, 63 Miss. 614.

Respectfully submitted,

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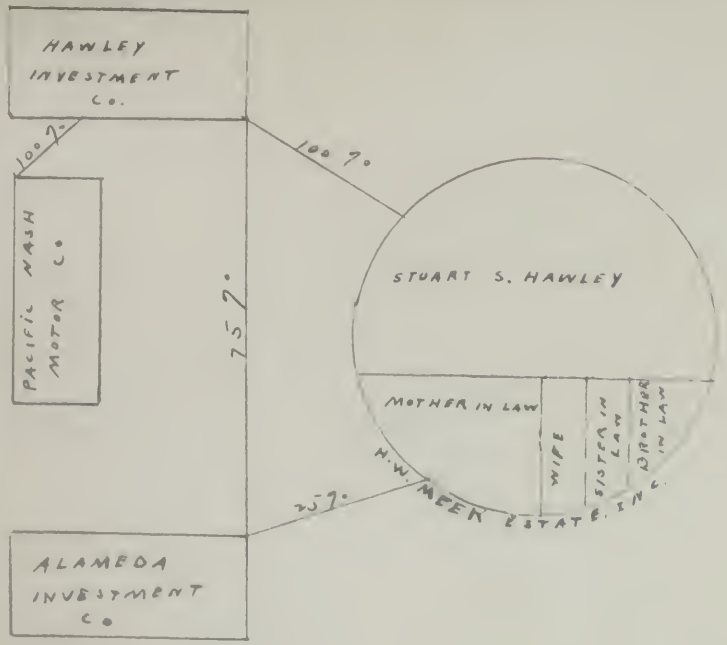
DIAGRAM NO. 1



I. HAWLEY INV. Co. ACTS AS GUARANTOR AND BAILEE OF ALL OF ALAMEDA'S BUSINESS VENTURES

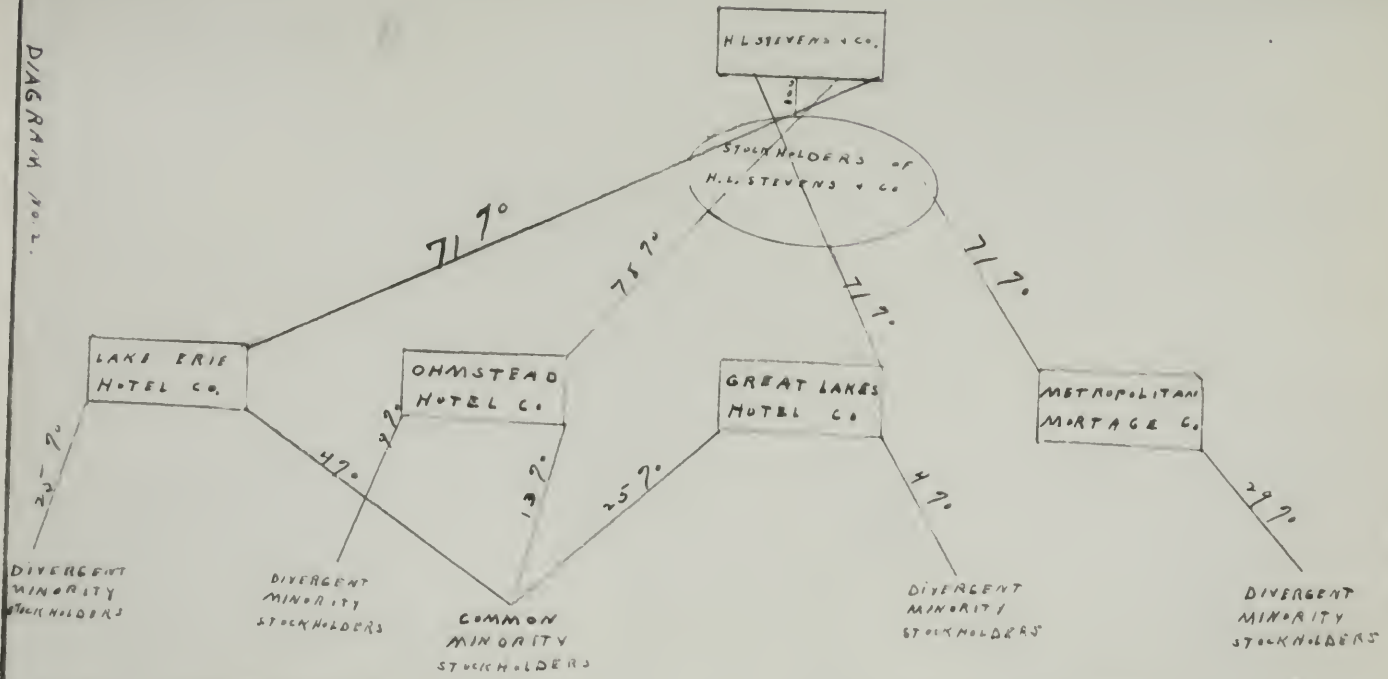
II. S.S. HAWLEY AND MEEK FAMILY CONSTITUTE "SAME INTEREST," BECAUSE OF RELATIONSHIP.

III. S.S. HAWLEY, BY POWERS OF ATTY, VOTES STOCK OF MEEK Co. OWNED BY HIS WIFE & MOTHER IN LAW; IS MANAGING DIRECTOR OF MEEK Co, AND VOTES ITS STOCK IN ALAMEDA Co.

IV. S.S. HAWLEY AND HAWLEY INV. Co. CONSTITUTE SAME INTERESTS AND OWN OR CONTROL ALL THE STOCK OF ALAMEDA.

DIAGRAM NO. 2.

GREAT LAKES HOTEL CO. Vs COMM. OF FED. (2d)



I MAJORITY STOCKHOLDERS: PURCHASED STOCK ON STEVENS NAME; AGREED TO GIVE PARENT FIRST CHANCE TO BUY THEIR STOCK; GAVE PROXIES TO CONTROLLING STOCKHOLDERS REGULARLY. THIS CONSTITUTED CONTROL

II AFFILIATION WAS ALLOWED: CORPORATIONS WERE A "BUSINESS UNIT", MAJORITY STOCKHOLDERS CONSTITUTED "CLOSELY AFFILIATED INTERESTS" AND OWNED PART OF THE STOCK AND CONTROLLED THE BALANCE. "CONTROLLED" IS BROADER THAN "OWNED"

COMMISSIONER V. ADOLPH HIRSCH & CO. INC. 30 FED (2d) 683

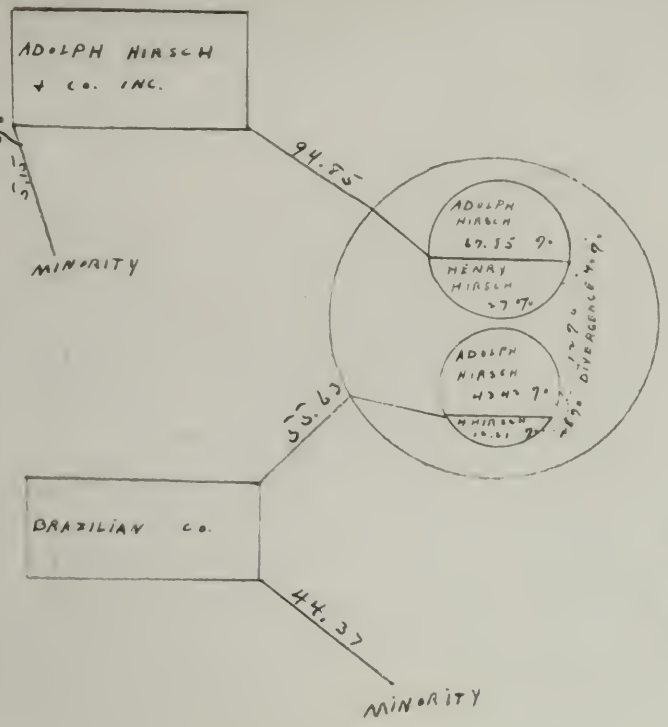


DIAGRAM No. 3.

I. HENRY HIRSCH OWNED 27.9% AS MUCH STOCK IN SUBSIDIARY AND 40.7% AS MUCH STOCK IN PARENT COMPANY AS HIS BROTHER ADOLPH, MAKING A 11.9% DIVERGENT INTEREST.

II. NEVERTHELESS, COURT HELD THEY WERE "SAME INTEREST" BECAUSE THEY WERE RELATED.

III. PARENT CONTROLLED BUSINESS OF SUB.

IV. MINORITY STOCK OF SUB. NOT CONTROLLED, AS ACQUIESCENCE, FRIENDSHIP OR PROFESSIONAL RELATIONS DO NOT CONSTITUTE "CONTROL"; NEITHER DOES CONTROL OF CORPORATE BUSINESS.

V. CONTROL OF STOCK REQUIRED.

VI. SINCE THERE WAS NO "CONTROL" OF MINORITY STOCK OF "SUB.", IT WAS UNNECESSARY FOR COURT TO ADD THE SUPERFLUOUS COMMENT THAT "CONTROL" MEANS BENEFICIAL INTEREST.